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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Canadian Minerals Developments: Trends and Implications

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1972

INTELLIGENCE MEMORANDUM

CANADIAN MINERALS DEVELOPMENTS: TRENDS AND IMPLICATIONS

Introduction

1. Canada and the United States are interdependent in minerals. The Canadians need US markets and capital, and the United States looks to Canada for rising supplies of essential minerals, particularly petroleum and natural gas. In addition to growing nationalistic tendencies, Ottawa perceives potential conflicts between Canada's continuing mineral development and its higher priority industrial program. This memorandum surveys the Canadian minerals industry, discusses its significance for both Canada and the United States, and assesses Ottawa's policy options toward future mineral development.

Discussion

Minerals in the Canadian Economy

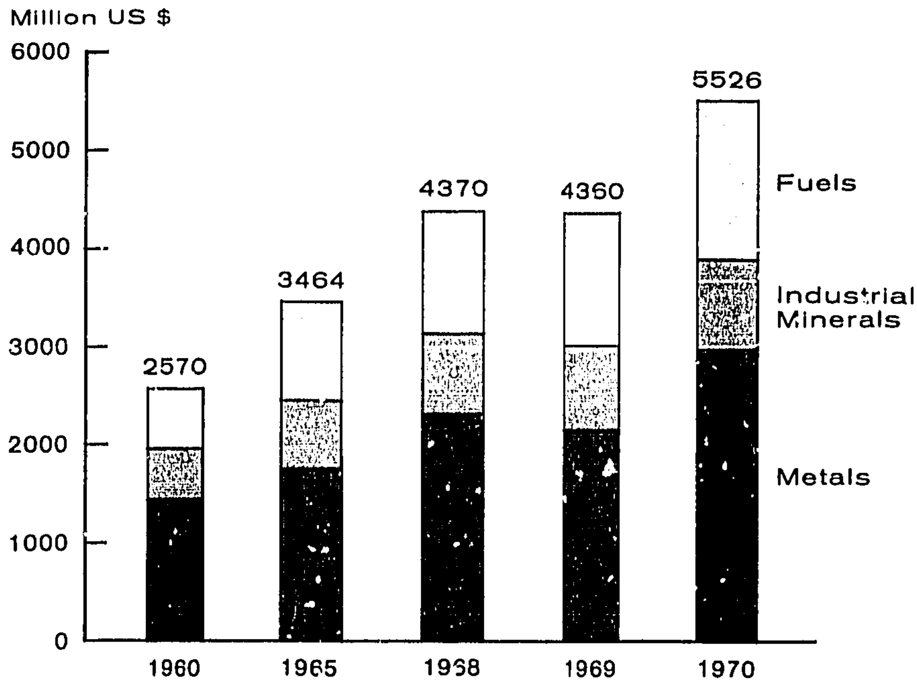
2. Canada's early history was entwined with mineral exploration and development. Indeed, much of the impetus to settle its west came from the lure of mineral riches thought to be found there. The most famous Canadian mining event was the Klondike gold rush of 1896, but the discoveries in the 20th century of cobalt, silver, uranium, asbestos, potash, and petroleum, as well as more copper, nickel, and iron ore, have been far more significant. These discoveries have revealed substantial reserves of most raw materials, and ongoing exploration – parts of Canada are relatively unexplored – is likely to result in the discovery of new deposits.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

3. Canada, the world's third largest minerals producer (behind the United States and the Soviet Union) produces some 60 minerals in quantities that both satisfy domestic demand and provide an exportable surplus. Mineral production was valued at $5.5 billion in 1970; by comparison, US mineral production was about $25 billion. Minerals sales account for about one-third of total exports, and primary minerals production accounts for about 7% of gross national product (GNP). Roughly $1 billion is invested in the industry annually, and the minerals industry directly provides jobs for more than 100,000 Canadians.

4. During the 1960s, Canada's mineral output grew 9% annually -- about twice as fast as GNP. Production expanded steadily throughout the decade with the exception of 1969, when prolonged strikes adversely affected output (see Figure 1). Production surged ahead in 1970 – up 27% over 1969 – but weak metal markets slowed the growth of output in 1971.

CANADA: Growth of Mineral Production* Figure 1



*Including values for minerals at various stages of processing. For example, the value of crude oil and iron ore are included, but refined petroleum products and iron and steel are excluded; the values for refined copper and nickel, however, are included in the statistics.

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In addition, appreciation of Canada's floating dollar squeezed the industry's profitability. In a number of cases, mining company profits fell more than 50% from 1970 levels.

5. Crude petroleum is Canada's leading mineral, accounting for almost 20% by value of the minerals industry's total output. Petroleum output increased 10% annually in the 1960s and thus was a major factor in the industry's rapid growth. Canada is tenth in the world, producing 1.4 million barrels per day (bpd). Other major products include nickel, copper, iron ore, zinc, and natural gas. These products, along with petroleum, account for 70% of Canada's mineral production (see Figure 2). Ontario is the leading mineral-producing province, accounting for 28% of production, led by nickel and copper from the Sudbury region. Oil and gas are responsible for Alberta's second-place ranking at 24% of total output, and asbestos, copper, and iron ore constitute the bulk of Quebec's 18% of production. The remaining provinces and territories account for only one-third of output (see Figure 2).

Mineral Trade

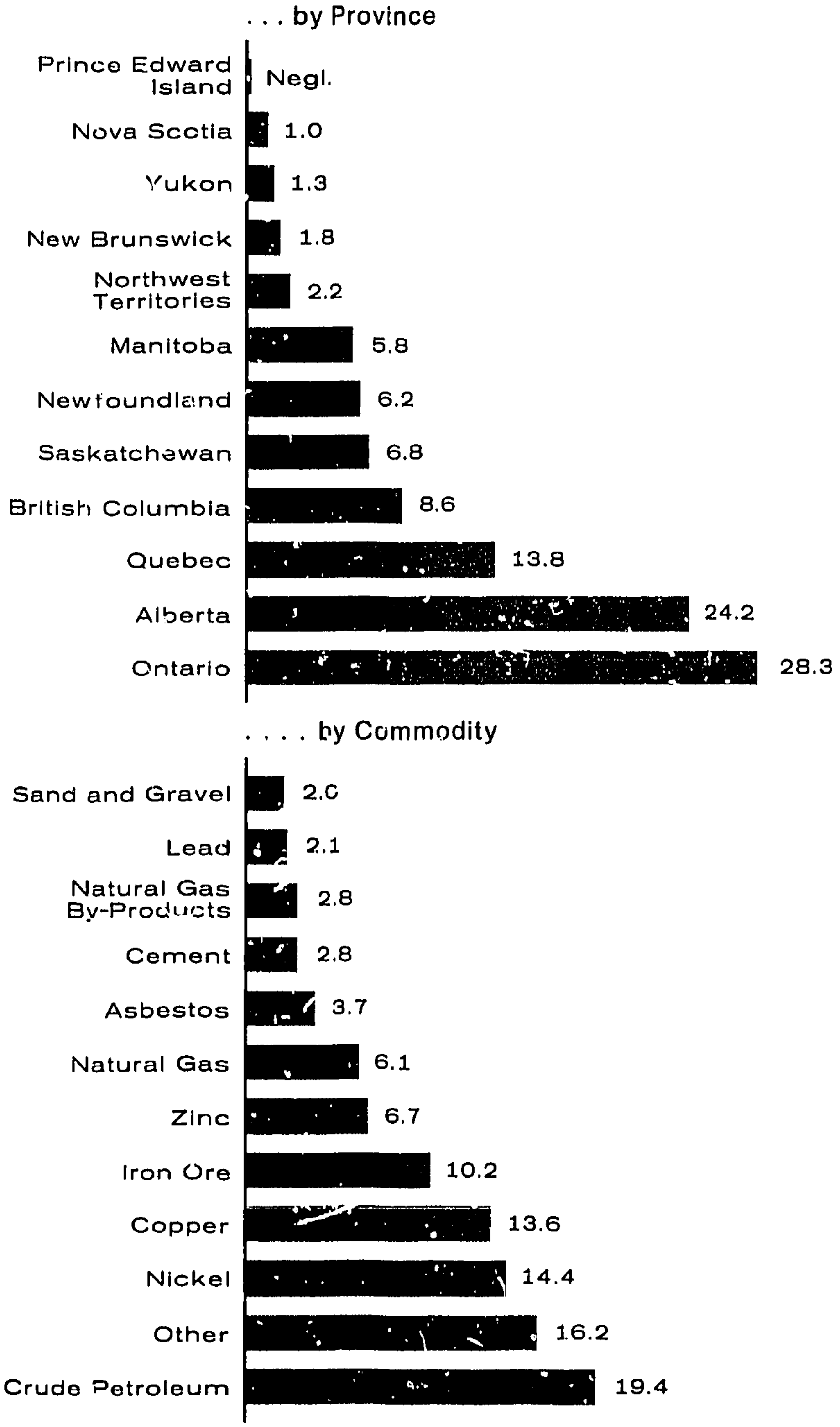
6. Canada is the world's leading mineral exporter. Because of a relatively small population of about 22 million people, domestic demand is insufficient to utilize the mineral industry's entire output: the bulk is exported to some 90 countries. Canada's rapid mineral export growth -- up 13% annually -- was largely responsible for the industry's development during the 1960s, as domestic consumption of Canadian minerals grew only about one-half as fast as exports.

7. By 1970, mineral exports reached $4.8 billion, compared with mineral imports of $1.3 billion. Canada imports tin, manganese, and chromite for its steel industry; bauxite and alumina for its aluminum industry; industrial diamonds; and some coal and petroleum. Net mineral exports in 1970 were valued at $3.5 billion, the largest favorable net balance for any commodity group. Indeed, Canada normally runs a non-mineral trade deficit -- $0.5 billion in 1970.

8. The United States is Canada's most important trading partner in minerals. In 1970 the United States took 50% of Canada's mineral exports and supplied more than one-half of Canada's mineral imports. The net mineral trade balance was $1.6 billion in Canada's favor. As shown in the table, Canada had a trade surplus with the United States in every category of mineral trade except solid fuels. Approximately 50% of total US mineral imports in 1970 of $4.8 billion came from Canada. Canada supplied nearly one-half the petroleum and three-fourths of the non-ferrous metals shortfall. Petroleum imports from Canada -- the United States takes about 60% of

CANADA: Percentage Distribution of Mineral Production, 1970 . . .

Figure 2



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Global US Mineral Trade Balance and Balance With Canada a/
1970

Million US $

Commodity Sector	Total US Imports	US Imports From Canada	Total US Exports	US Exports to Canada	US Global Balance	US Balance With Canada
Metallic ores and scrap	1,100.0	500.4	938.2	170.5	-161.8	-329.9
Coal, ccke, and briquettes	21.6	1.8	1,600.0	146.1	1,578.4	144.3
Crude petroleum	1,425.6	621.8	18.4	0	-1,407.2	-621.8
Natural gas	293.2	197.3	62.6	4.9	-230.6	-192.4
Nonferrous metals	1,650.0	933.1	963.9	417.5	-686.1	-515.6
Nonmetallic minerals	284.9	124.8	319.1	53.6	34.2	-71.2
Total	4,775.3	2,379.2	3,902.2	792.6	-873.1	-1,586.6

a. Based on US trade data.

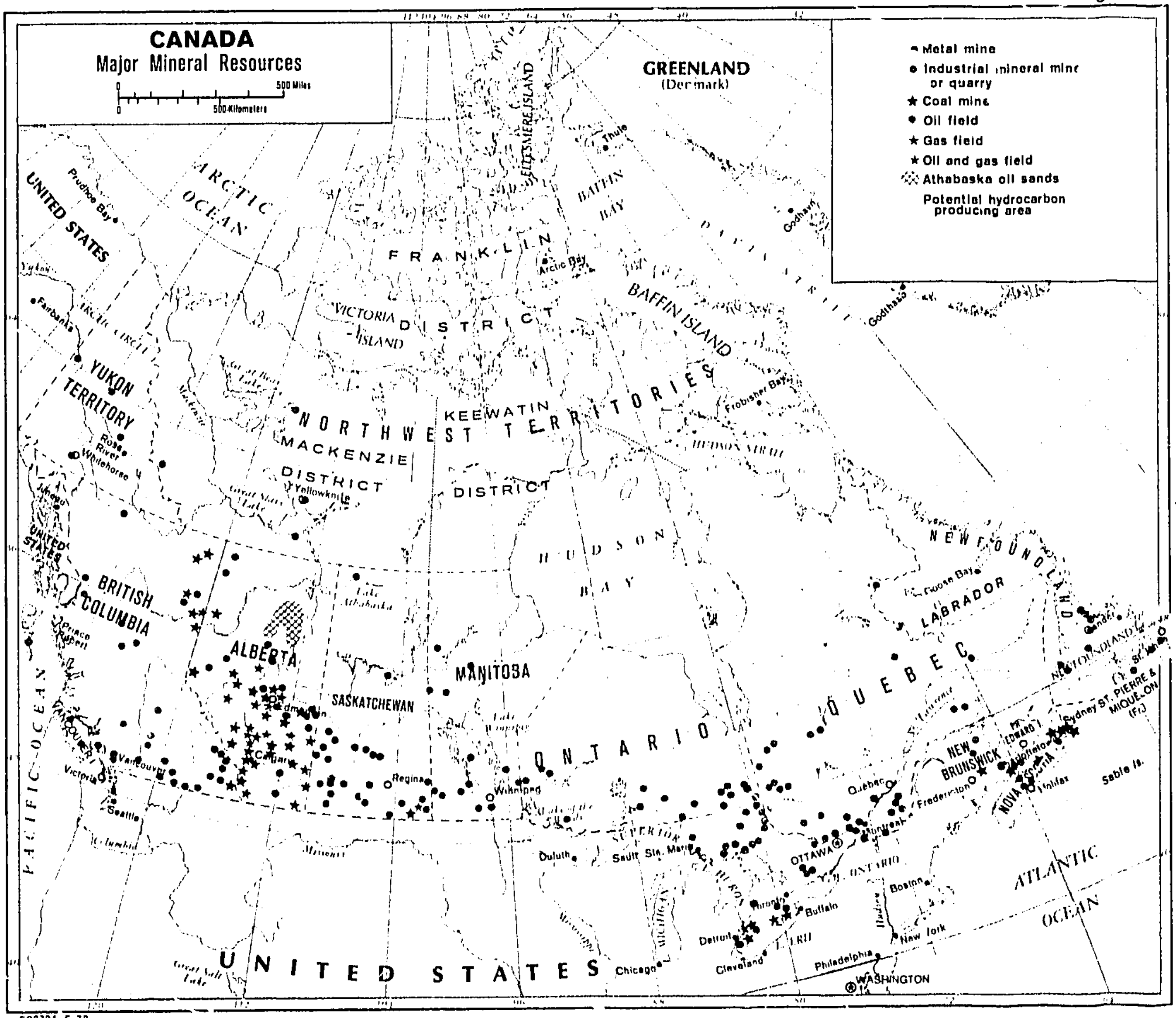
Canada's oil and gas production -- met 5% of US demand, while imports of Canadian nickel, silver, zinc, and copper accounted for 75%, 30%, 23%, and 6%, respectively, of US consumption of these metals.

9. The US-Canada mineral trade has a distinct geographic pattern (see the map, Figure 3). Western Canada, because of a limited industrial base, is particularly dependent on exports. All of its oil and gas exports are to the United States, and the United States and Japan take the bulk of other minerals. Eastern Canada, however, utilizes much of its mineral production in its manufacturing industries, exporting most of the remainder to the United States. In contrast to the west, the eastern portion of the country is not self-sufficient in minerals, and must import coal, oil, and some industrial raw materials. High transport costs often make western minerals less attractive in the east than imports.

10. Although the United States is the largest market for Canadian minerals, Japan is the most dynamic. Japan is the world's largest importer of minerals, and Canada, because of its growing mineral production and new port facilities capable of handling large bulk carriers, is in an excellent position to supply some of these needs. In 1970, Japan imported \$361 million of Canadian minerals and was its largest customer for copper and lead concentrates and coal; it also was a major buyer of Canadian aluminum, asbestos, molybdenum concentrates, and pig iron. That year Canada provided 24% of Japan's imports of zinc concentrates, 56% of lead concentrates, 15% of copper concentrates, 5% of coking coal, and 2% of iron ore. Since 1960, mineral exports to Japan have grown 22% annually. In 1960, minerals accounted for 26% of Canada's total exports to Japan; by 1970 they had jumped to 48%. The European Community and the United Kingdom each account for a larger proportion of Canada's mineral exports than does Japan, but increased purchases will likely push Japan into second place by the mid-1970s. Major markets for Canada's mineral exports are as follows:

	Percent
United States	50
United Kingdom	15
European Community	10
Japan	8
Other	17

Figure 3



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Foreign Investment in the Minerals Industry

11. Canada has been unable to generate domestically the vast amounts of capital required to finance the growth of its minerals industry. Canada has turned, therefore, to foreign capital sources, particularly the United States. Data for 1967 – released this year – show that the United States controlled $5.8 billion, or 60%, of the capital employed in the petroleum and natural gas industry, and $2.9 billion, or 56%, in the mining and smelting industry. Third countries accounted for the control of 14% and 9%, respectively, of the capital in these industries. The United Kingdom controlled about one-half of the third-country total in each case.

12. Japan is just beginning to become an important capital supplier. In the last few years the Japanese have entered into a number of agreements with Canadian mining companies, and their equity plus long-term credits now total nearly $200 million. The long-term credits are usually tied to contracts for the supply of needed minerals and are mainly used to develop or enlarge mines, whose output is then shipped to Japan for refining.

13. By 1970, one-third of Japan's financial interests were in Canadian copper ventures. In no case, however, did a Japanese firm have a majority equity share, and in most cases, the interest was in the form of a loan for a combination of loan and small equity share. Rather than seek control over the Canadian enterprises in which it invests, Japan's goal is to secure stable, long-run supplies of resources.

Mineral Development Policy Issues

. Minerals vs. Manufacturing

14. A decade ago conventional wisdom held that Canada's future lay in the exploitation of its rich mineral resources. Large reserves and rising world demand for minerals combined to create a favorable future for the growth of the minerals industry. This policy is now being reconsidered, however, because of the emergence of persistant unemployment and the specter of more to come. With its labor force expected to continue to be the fastest growing of any industrial nation, Canada's main economic problem will be the creation of new jobs. Prime Minister Trudeau's government has looked to more secondary manufacturing, which is relatively labor intensive, for employment expansion rather than to growth of the extractive industries, which are relatively capital intensive. Secondary manufacturing, however, must be export oriented, as economies of scale often require larger production runs than the domestic Canadian market can absorb.

15. Most Canadian leaders undoubtedly would like to see both manufacturing and mining output grow rapidly, but this situation would create a conflict between the two industries. A continued expansion of the minerals industry would require increased exports as well as further foreign investment in the industry. The large inflow of foreign exchange would tend to cause the floating Canadian dollar to appreciate, making Canadian manufactures less competitive in foreign markets and foreign manufactures more attractive at home.

16. Although export taxes or investment curbs might be used to moderate growth in the minerals sector, it would be difficult to adopt measures that would decelerate the growth. Besides the 100,000 people directly employed, probably close to an additional one-half million indirectly owe their jobs to the minerals sector. Many provincial leaders also recognize the role that minerals play in their economies; political resistance would be strong against any policies that would retard continuing development. Canada needs the dynamic contribution of a healthy minerals sector, and would find it difficult to sacrifice the exports, growth, and employment generated by it.

17. An indication of Trudeau's thinking on minerals policy was furnished by the 1971 tax reform law, and further clarification will probably be contained in the government's energy message due at year-end. Tax reform did not place discriminatory burdens on the industry; rather, it reduced the degree of favorable treatment. The new rules abolished an automatic depletion allowance that was equal to 33% of profits. In its stead, a less generous system of "earned" depletion was introduced. This allows mines to claim as a depletion allowance one-third of expenditures on exploration, processing plants, and certain other items. Nevertheless, these lost benefits are not likely to have much more than a marginal adverse impact on mineral development.

Continental Energy Policy

18. The United States, becoming increasingly dependent on imported oil, is looking to Canada to supply some of its future needs. Production in the "lower 48" states is expected to peak this year or next, and Alaskan crude oil will not make a substantial contribution before 1976. Industry forecasts indicate that the United States will import at least 6 million bpd of oil in 1975 and 10 million bpd in 1980. Also, US demand for imports of natural gas will rise sharply in coming years.

19. The growing US supply shortages and the Alaskan North Slope oil discoveries in 1968 have given renewed impetus to the concept of a "continental" or "common" energy policy between the United States and

Canada, which was originally proposed more than 20 years ago. The United States has been the major proponent of a bilateral understanding on energy policy. The concept, however, has run up against political problems in Canada.

20. The general Canadian view is that energy trade between the two countries should be governed primarily by economic factors and that, apart from the activities of regulatory agencies, government involvement should be minimal. Canada, currently gripped by rising nationalism, is unwilling to enter into a formal agreement, feeling that this would further subject it to US domination. Also, the Canadians feel that long-run Canadian needs should be provided for before resources are committed to export markets. The United States seeks a comprehensive bilateral understanding that would assure supplies of oil and gas. This understanding goes beyond mere reliance on the expectation that Canadian exports of energy commodities to the United States will automatically grow as required.

21. Canada's ability to increase its exports of oil to the United States in the 1970s depends in large part on the success of exploration in the north and Atlantic offshore areas. Although Canada's proved oil reserves more than doubled in the 1960s, there has not been a major new find since 1965. However, current drilling in the north – the Mackenzie delta and Arctic islands – looks promising. Estimates of oil reserves in the delta range as high as 3 billion to 5 billion barrels, and potentially large gas fields lie in the Arctic islands. In addition, oil has been found off Canada's eastern coast at Sable Island.

Ownership

22. Many Canadians find the high degree of US ownership of the minerals industry distateful. Although only the most ardent nationalists would advocate "buy back Canada" policies or a complete prohibition on foreign investment, the feeling is general that foreign ownership should at least be monitored. Canadians fear that they are selling their birthright to US industry. US firms own, and US capital has developed, the Canadian minerals industry. More than 40% of the output of this industry is in turn exported to the United States. Depletion of non-renewable resources for non-domestic use undermines national security in the long run. In the near term, Canadians recognize that the minerals sector's contribution to the economy would be drastically curbed if the bulk of output could not be exported.

Export Diversification

23. Ottawa also would like to diversify its markets for its minerals exports, believing excessive dependence on the United States is hazardous.

For example, US policy on uranium imports has caused the value of Canada's uranium output to fall 85% from the peak reached around 1960. Canada's uranium mining flourished then under the impetus of US contracts and investment. The US Atomic Energy Commission then placed restrictions on uranium imports. The results were damaging for Canada: an industry originally encouraged by the United States is now operating at only one-third of capacity.

24. Despite the growth of other markets for Canada's minerals, the dominant position of the United States will not easily be eroded. Trading links are firmly established, and many firms in the industry are controlled in the United States. In addition, growing US demand for minerals, along with the size of the market, will cause it to increase its imports greatly in the years ahead.

Prospects

25. Canada's minerals industry will grow rapidly during the 1970s. The country possesses large reserves of many vital minerals, and continued worldwide industrialization will draw on this mineral wealth. Indeed, with mineral demand in major developed countries expected to far outpace their resources, Canada is in an excellent position to increase its position as the world's leading mineral exporter.

26. Despite the desire to alter its policies toward mineral development, Ottawa has few alternatives. It would be difficult to use the potential conflicts between industrial policy and the further growth of the minerals industry to stop the industry's growth. Certain policies -- depreciation allowance changes, the possible imposition of some form of export taxes, or greater regulation of foreign investment in the industry -- could be employed to moderate growth, but not to curtail it sharply. Attempts to slow drastically the industry's expansion would arouse a domestic furor that no government would willingly invite. Secondary manufacturing will stressed, but minerals growth will not be sacrificed.

27. Nor will Canada be able to reduce greatly its dependence on US markets or long-term capital. The deficit in net US minerals consumption could reach $5 billion by 1975, and much of this deficit will be met by imports from Canada. Although the US share of Canada's total mineral exports may decline somewhat in the face of increasing sales to Japan and Western Europe, in absolute terms the United States will remain the largest customer. Despite a likely increase in domestic and Japanese investment, the vast amounts of capital required will necessitate the use of US financing. Although foreign investment will face increasing regulation and scrutiny, Canada will be unwilling to cripple its minerals industry by shutting off

inflows of needed funds. Thus Ottawa is unlikely to adopt policies that will significantly reduce Canada's minerals growth, diversify its export markets, or curtail the use of foreign capital.